

Private Letter Ruling: An exempt organization is automatically exempt from Illinois taxation if it is exempt from federal income taxation.

February 26, 2003

Dear:

This is in response to your letter dated January 14, 2003, in which you request a Private Letter Ruling on behalf of COMPANY. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of 86 Ill. Adm. Code Section 1200.110 appears to be contained in your request. The Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit nor involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows :

We represent the COMPANY and are requesting a private letter ruling on behalf of COMPANY and its single-member limited liability company ("LLC") with respect to the imposition of the Illinois personal property replacement income tax. COMPANY hereby requests a private letter ruling that COMPANY and/or its LLC are exempt from the Illinois personal property replacement income tax.

#### STATEMENT OF FACTS.

COMPANY is an instrumentality of the State of Wisconsin created pursuant to section 15.76 of the Wisconsin Statutes and operated pursuant to Chapter 25 of the Wisconsin Statutes, *Trust Funds and Their Management*. COMPANY's purpose is to provide professional investment management of various trusts and operating funds established under the laws of the State. Wisc. Stat. ¶25.15(a).

Internal Revenue Service Position. The Internal Revenue Service (the "IRS") has determined that COMPANY is exempt from federal income taxation under section 115 of the Internal Revenue Code (the "Code"). See Exhibit A. The IRS also certified that COMPANY operates as "a trust forming part of a pension, profit-sharing, or stock-bonus plan qualified under section 410(c)" of the Code, and is therefore exempt from federal income taxation under section 501(a) of the Code. Finally, the IRS has determined COMPANY to be an exempt organization described in section 501(c)(3) of the Code and a supporting organization described in section 509(a)(3) of the Code. COMPANY has never filed a federal income tax return. See Exhibits B and C.

Business Purpose for Transaction. The LLC will be a newly-formed single member limited liability with COMPANY as the sole member. The sole purpose of the LLC is to hold certain real estate located in Illinois (the "Property") for COMPANY in order to shield COMPANY's other investments from any liabilities associated with owning and operating the Property. Although COMPANY is authorized to invest certain of its funds under its jurisdiction in real estate (Wisconsin Statutes sections 25.17(3)(2) and 620.22), COMPANY wants to avoid exposing its other assets to the potential liabilities associate with real estate ownership.

If COMPANY holds title to real estate directly, it could be subject to unlimited liability for tort damages (including punitive damages) and for costs of environmental contamination and cleanup. Those liabilities, if realized, would not only diminish COMPANY's return on investment in the real estate, but could also put COMPANY's other assets at risk. In contrast, if COMPANY acquires and holds title through a limited liability company, then the limited liability company would bear those risks of liability, and COMPANY and all of its other assets would be isolated from those risks by virtue of the "corporate veil."

Protection from tort and environmental liability is not the only benefit to COMPANY of holding title through a limited liability company. In addition, COMPANY may not be subject to real estate transfer and mortgage recording fees in some jurisdictions if it transfers ownership of the limited liability company to a purchaser, instead of transferring title to the real estate, and may thereby enhance the return on its real estate investment. COMPANY may also benefit from using a limited liability company because a limited liability company is not the "deep-pocket" target of litigation that COMPANY itself might be.(note)

#### RULINGS REQUESTED.

On behalf of COMPANY and its wholly-owned single-member LLC, we respectfully request that you rule as follows:

1. Neither COMPANY nor its LLC are required to file any Illinois tax returns based on the income generated by the activities conducted by the LLC, including personal property replacement income tax returns.
2. No portion of the income generated by the activities conducted by the LLC will be subject to taxation by the State of Illinois, including personal property replacement income taxes.

#### ANALYSIS.

Illinois Department Of Revenue ("Department") has previously ruled that "to the extent the entity could 'exclude income federally under Section 115 [of the Code], such income will be similarly excluded for Illinois Income Tax Act (IITA) purposes'" in General Information Letter ("GIL") (see Exhibit F). This GIL also cites Letter Nos. IT 94-0094-GIL, dated August 12, 1994. IT 90-0276, dated October 22, 1990 and IT 91-022, dated May 7, 1991. In this GIL the Department states that "[t]he Illinois Income Tax Act did not contemplate or intend to impose an income tax on any state of the United States..." or "to impose directly or indirectly a tax on the income generated by the activities of a state or political subdivision."

The Personal Property Replacement Income Tax was enacted in 1979 to replace the corporate personal property tax abolished by the Illinois Constitution. The personal property replacement income tax is an additional income tax imposed on corporations. However, the replacement tax is treated as one tax along with the corporate income tax to not violate the Section 5 Constitutional provision limiting to one the taxes that could be imposed on corporate income (Ill. Const. Art. IX, §5(c)). In effect, the replacement

tax is treated as part of the corporate income tax and is measured by the same net income. 35 ILCS 5/201(c). Since the courts and the Department have concluded that income will not be taxed directly or indirectly, COMPANY and its LLC are not required to file either the Illinois income/franchise or the personal property replacement income tax return.

Even if COMPANY and/or its LLC are required to file an Illinois Form 1120 (sic), its income is excludable from gross income for both corporate income taxes and the personal replacement income tax pursuant to Code section 115(1). Prior Department rulings including Letter Nos. IT 91-0122 dated May 7, 1991, IT 89-0314 dated December 21, 1989, IT 90-0276 dated October 22, 1990 and IT 94-0094-GIL dated August 12, 1994 support this conclusion.

#### OTHER ADMINISTRATIVE MATTERS.

The following information is being provided pursuant to 2 Illinois Administrative Code 1200(b).

1. The tax periods at issue are tax years subsequent to 2002.
2. Neither COMPANY nor its LLC are under a current audit or involved in any litigation with the Department.
3. To the best of the knowledge of COMPANY, its LLC and their representative, the Department has not ruled on the same or similar issue and neither COMPANY, its LLC nor its representatives have previously submitted the same or similar issue and withdrew the request prior to a letter ruling being issued.
4. The undersigned could find no authorities contrary to the requested ruling.
5. The ruling request contains no trade secret information that must be deleted prior to public dissemination other than COMPANY requests that its name be deleted prior to public dissemination.

#### CONCLUSIONS.

1. Based on several Department private letter rulings, COMPANY and LLC are not required to file Illinois income tax returns, including Illinois Form 1120 (sic).
2. Even if COMPANY and/or LLC must file returns, the income excluded from gross income pursuant to Code Section 115(1) is also excluded for purposes of calculating Illinois taxable income.

In response to your inquiry, please be advised as follows:

The Illinois Income Tax Act (IITA) does not define the term "trust". However, IITA 102 provides that

(e)xcept as otherwise expressly provided or clearly appearing from the context, any term used in this Act shall have the same meaning as when used in a comparable context in the United States Internal Revenue Code of 1954 or any successor law or

laws relating to federal income taxes and other provisions of the statutes of the United States relating to federal income taxes as such Code, laws and statutes are in effect for the taxable year.

Resultantly, Illinois is bound to follow the IRS characterization of COMPANY as a trust for income tax purposes. 86 Ill. Adm. Code 100.9750(e). In the case of a trust, the starting point for determining income subject to Illinois taxation is federal taxable income as modified by IITA 203(c)(2). Since, as you have stated, COMPANY is exempt from federal income taxation under IRC 115, it will have no federal taxable income for Illinois purposes. Thus, unless COMPANY has an excess of Illinois addition modifications over subtractions, it will likewise have no Illinois taxable income. As indicated in GIL IT 94-0094 (8/12/94), at page 3, there are no addition modifications applicable to an entity such as COMPANY, which is formed on behalf of a political subdivision.

Under IITA 502(a)(2), a taxpayer having no Illinois income tax liability is only required to file an Illinois Income Tax return if the taxpayer is a resident or a corporation qualified to do business in Illinois, which taxpayer is also required to file a federal income tax return. Based upon your representations, it appears that COMPANY, a non-resident trust, will not need to file an Illinois Income Tax return.

IITA 1501(a)(4) defines the term "corporation" to include "associations, joint-stock companies, insurance companies and cooperatives. Any entity, including a limited liability company formed under the Illinois Limited Liability Company Act, shall be treated as a corporation if it is so classified for federal income tax purposes."

In a letter dated July 23, 2002, included with your correspondence, Christine Ellis, Chief, Branch 3, IRS, discusses your agency's request for a ruling regarding the federal taxability of CORPORATION, LLC, the LLC which is the subject of your current request for a PLR from the DOR. At page 4 of her letter, Ms. Ellis states that, "[b]ased on Rev. Rul. 78-316, 1978-2 C.B. 304, LLC, classified as a corporation subject to tax under subtitle A of the (Internal Revenue) Code, is required to file a federal income tax return under §6012(a)(2)." The letter continues on to state that IRS has no opinion regarding whether LLC is a disregarded entity under §7701.

The Department is bound to accept LLC's designation as a corporation for federal income tax purposes. 86 Ill. Adm. Code 100.9750(a)(1). Further, absent a clear ruling from the IRS to the contrary, we must consider the LLC to be a separate legal entity for IITA purposes. That being the case, the starting point for determining LLC's Illinois Income Tax liability will, like COMPANY, begin with its federal taxable income. If, like COMPANY, LLCs income is excluded from gross income under IRC 115, by virtue of its being engaged in essential government functions which accrue to a state or political subdivision thereof, none of the applicable addition modifications will apply. GIL IT 94-0094. However, LLC will be liable to file an Illinois income tax return under the test of IITA 502(a)(2) if it is both required to file a federal income tax return and it is qualified to do business in Illinois (with the Office of the Illinois Secretary of State).

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Sincerely,

Jackson E. Donley,  
Senior Counsel-Income Tax